

## **Chapter 3**

# **Cost Principles and Allowable Costs**

## **Introduction**

This chapter offers guidance to JTPA recipients and subrecipients on JTPA allowable cost principles and makes suggestions for developing State JTPA allowable cost guidelines.

This chapter contains the following subsections:

- \* Allowable Cost Principles
- \* State Requirements for Developing Allowable Cost Guidelines
- \* JTPA Regulation Allowable Cost Guidelines
- \* Governor's Sixteen Selected Items of Cost

While the OMB Cost Circulars (A-21, A-87, and A-122) were used in the development of this chapter, this does not mean that they are or should be generally applicable to JTPA. They provide a foundation for States to build their allowable cost guidelines, which is preferable to starting from scratch. They should also be familiar to most financial management personnel. All references in this chapter to "OMB Circulars", unless stated otherwise, will be to the Cost Circular group A-21, A-87, and A-122. References to Proposed A-87 is to the proposed version published in the Federal Register on August 19, 1993, for public comment.

With the exception of items specifically addressed in the JTPA Regulations, the discussion of allowable cost guidelines is intended only to provide suggestions and provoke thought.

### **What the Act Requires**

Section 164(a)(2) of the Act, as amended, requires the Secretary to prescribe regulations establishing uniform cost principles substantially equivalent to those generally applicable to recipients of Federal grant funds.

### **JTPA Rules Establish Cost Principles**

In response to this requirement, the JTPA Regulations at paragraphs (a) through (d) of 627.435 establish cost principles, and paragraphs (e) through (h) provide guidance on the allowability and unallowability of specific items of cost. Paragraph (i) of 627.435 contains a listing of selected items of cost for which the Governor must establish guidelines.

### **Federal Cost Principles Differ From JTPA**

This approach contains two significant differences from the Federal cost principles contained in the OMB Cost Circulars. The differences are:

- \* There is no JTPA requirement for recipients to submit Indirect Cost Rate Proposals to the cognizant Federal agency and obtain Federal approval. However, some government agencies that receive JTPA funds may be required to submit indirect cost rate proposals based on another source of direct (non-JTPA) Federal funding.

\* Attachments to the OMB Cost Circulars detail specific treatment of selected items of cost, while the final JTPA Regulations provide specific guidance for a few items and require that the Governor establish guidelines for, at a minimum, 16 other items. This approach ensures that the same items of costs will be treated by all States, and is meant to provide the States with sufficient flexibility to tailor guidelines that will blend administratively with State-specific practices, provide flexibility to best meet State and local needs, help ensure that the success of the JTPA program is not linked to Federal regulations that do not take local conditions into account, and provide a method for revising cost guidelines more quickly to meet changing needs.

Section 627.435(i) requires that for SDAs, SSGs, and Statewide programs, the Governors issue allowable cost guidelines for at least 16 items.

Before developing guidelines for specific items, States should develop a philosophy on prior approval and consider what the JTPA procurement rules at 627.420 are designed to achieve.

### **Allowable Cost Principles**

The JTPA Regulations at 627.435 specifically list the following 7 principles for determining cost allowability:

- \* Necessary and reasonable
- \* Allocable to the program
- \* Not a general expense of the Governor or a governmental subrecipient
- \* Consistent treatment through application of GAAP
- \* Use of OMB Cost Circular definitions of direct and indirect costs
- \* Cost allocable to other cost objectives may not shifted to a JTPA cost objective
- \* Applicable credits are to reduce the cost of the program or be returned to ETA

These "generic" cost principles are intended by ETA to be substantially the same as the provisions of Attachment A of the OMB Cost Circulars that contain cost principles, and should generally be interpreted the same as the Circulars.

The following discussion includes the above principles specified at 627.435 and other "generic" cost principles from the OMB Cost Circulars affecting allowability.

### **JTPA Specific Cost Principles**

The following principles must be used for determining cost allowability for JTPA funded programs.

#### **Necessary and Reasonable**

The Act and Regulations require that JTPA costs be necessary and reasonable for the proper and efficient administration of the grant programs.

A cost is reasonable if, in its nature or amount, it does not exceed what would be incurred by a prudent person under the circumstances prevailing at the time the decision was made. The question of the reasonableness of specific costs must be scrutinized carefully when it involves organizations that receive most of their support from awards made by Federal agencies. Do the costs incurred for administering the JTPA grant appear reasonable when compared with

costs incurred for administering other Federal grant programs? In determining the reasonableness of a given cost, consider the following:

- \* Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the award.
- \* The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
- \* Market prices for comparable goods or services.
- \* Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Government.
- \* Significant deviations from the established practices of the organization that may unjustifiably increase the award cost.

### **Allocable to the Program**

Costs must be allocable to the JTPA title and cost category to the extent of benefits received by the program. Allocability generally relates to the question of amount rather than kind of cost. For example; there is no doubt the JTPA program should share the cost of rented space in a building jointly occupied with other programs. The question most often arising is how much should be JTPA's share. If square footage is used as the measure of relative benefits, the square footage actually occupied by the various programs is a good relative measure of benefits received and is satisfactory for use. To alter the square footage for the rent allocation calculation for one or more programs simply to achieve a different result would result in costs not being allocable to the extent of benefits received and would violate this principle. Chapter 4 contains more discussion on cost allocation and cost pooling.

**Not a General Expense of the Governor or a Governmental Subrecipient** Examples of such costs include:

- \* Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executives of federally recognized Indian tribal governments.
- \* Salaries and other expenses of State legislatures, Tribal councils or similar local government bodies such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction.
- \* Cost of the judiciary branch of a government.
- \* Cost of prosecutorial activities unless authorized by program regulations.
- \* Other general types of government services normally provided to the general public such as fire and police.

### **Consistent Treatment Through Application of Generally Accepted Accounting Principles**

Costs should be accorded consistent treatment through application of generally accepted accounting principles appropriate to the type of organization involved.

### **Use of OMB Cost Circular Definitions of Direct and Indirect Costs**

The JTPA Regulations specify that the definitions for direct and indirect costs contained in the OMB Cost Circular applicable to the type of organization involved be used to determine whether costs are direct or indirect. Chapter 4, Cost Allocation and Cost Pooling, has a complete discussion of direct and indirect costs.

### **Costs Allocable to Other Cost Objectives May Not be Shifted to a JTPA Cost Objective**

The "flip side" of costs allocable to the program based on benefits received is that the JTPA program, its various titles and cost categories must not be charged costs that benefit other programs, titles, or cost categories. Costs must not result from a shift of costs allocable to other grants, programs, or cost categories to overcome fund deficiencies, to avoid restrictions imposed by law, or for other reasons. This prohibition does not apply to cost adjustments to correct errors or misclassifications as long as the costs ultimately charged to a cost objective are those properly allocable to that cost objective.

### **Applicable Credits Are Used to Reduce the Cost of the Program or Are Returned to ETA**

Costs should be net of all applicable credits. The term applicable credits refers to those receipts, or reduction of expenditures, that offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to JTPA costs, they are to be credited to the JTPA program if the grant is still active, or returned to the Employment and Training Administration if it has been closed.

### **"Generic" Cost Principles**

Because the OMB Cost Circulars are generic to Federal grants, they group the following items together and discuss them as broad cost principles without the program specific detail that only program regulations can provide. While these principles are not specifically listed in the JTPA Regulations with the group of seven listed above, they are referenced within the JTPA Regulations, are important, and should be considered in making decisions concerning the expenditure of funds.

### **Authorized or Not Prohibited**

Costs incurred in grant programs should be authorized and not prohibited under Federal, State or local laws or regulations. The Act and the Regulations identify certain cost items as being either specifically allowable or unallowable. An example is the provision that entertainment costs are unallowable.

### **Conform to Limitations or Exclusions**

Costs should conform to any limitations or exclusions set forth in the JTPA Regulations, or other governing limitations as to types or amounts of cost items. Cost limitations as a percentage of funds allocated are examples of this principle.

### **Consistent with Grantee Activity**

Costs should be consistent with policies, regulations, and procedures that apply uniformly to other activities of the agency of which the grantee is a part. An example of a violation of this concept would be to provide a car, at JTPA expense, for the county JTPA director when cars are not provided to any other county department directors.

### **Conform to Cost Sharing or Matching Requirements**

Unless specifically authorized, costs should not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.

### **Documented**

The proposed OMB Circular A-87 stipulates that costs be "adequately documented". The JTPA Regulations treat this issue at 627.425 separately from the cost principles at 627.435. The JTPA Regulations require, in part, "source documentation to support accounting records" and documents that "permit the tracing of funds to a level of expenditure adequate to establish that funds have not been used in violation of the applicable restrictions on the use of such funds". Consideration should be given to documenting the rationale for incurring costs that are not immediately and easily determined to be necessary and reasonable for the program at the time the expenditure is made.

### **Post Termination Costs**

Because the JTPA Regulations do not provide allowable cost guidance for post termination costs, any organization anticipating such costs should resolve the issue with its funding organization prior to incurring any such costs.

## **State Requirements for Developing Allowable Cost Guidelines**

In the past, the OMB Cost Circulars have not applied to the JTPA program. If a State adopted these circulars for its JTPA programs, it would be as a State, not Federal, requirement. This is still true with the amendments and the revised Regulations.

### **Governor's Role in Establishing Allowable Cost Guidelines**

While the regulations have become more specific, it is up to the Governor to establish most of the allowable cost guidelines. The Governor is required to prescribe and implement allowable cost guidelines for Service Delivery Areas (SDAs), Substate Grantees (SSGs), and statewide programs that are consistent with the cost principles and other allowable cost provisions specified at 627.435. In addition to the allowable cost provisions of paragraphs (e) through (h), the Governor is free to establish guidelines for as many or as few cost items as deemed necessary as long as at least the 16 specific items listed at 627.435(i) are addressed in some manner. While some consideration should be given as to how the OMB Cost Circulars treat these 16 items, the JTPA Regulations leave it to the Governor to decide whether they are allowable costs. The Governor's guidelines must include the following four items:

- \* Whether the item is allowable or unallowable.
- If allowable:
  - \* Guidelines on conditions or the extent of allowability
  - \* Documentation requirements
  - \* Any prior approval requirements

### **Review, Review, and More Review**

Most States' existing allowable cost guidelines probably meet the requirements of 627.435(i). However, all States should review their current guidelines to ensure that the cost items in 627.435 are included, as well as any other cost items that need guidelines. States should also verify that the above four items are adequately addressed in their guidelines.

Even those States that have adopted the OMB Cost Circulars should review their guidelines to ensure that the circulars either address each item, as desired, or that appropriate State guidance has been added. Fund-raising, for example, is not covered in the current OMB Circular A-87 for State and local governments, but is addressed in both A-21 and A-122. Payments to on-the-job-training (OJT) employers, training institutions, and other vendors are not specifically addressed in any of the circulars.

### **Best Advice for How to Use OMB Cost Circulars**

A reasonable approach is to use the OMB Cost Circulars as a foundation for developing State allowable cost guidelines. It is also wise to take advantage of the flexibility of the JTPA and Regulations to keep administrative burdens to a minimum.

Blanket adoption of one or all of the Circulars is not recommended and will not fulfill the State's responsibility for the guidelines. The Circulars probably contain restrictive requirements in areas in which States, SDAs, and SSGs may desire greater flexibility. Circulars that are adopted without modification would require State, not Federal, approval for those items on which the Circulars require prior approval, because ETA has made it clear that it will neither approve nor disapprove such requests. This could easily generate an unwanted workload for the Governor's Administrative Entity (GAE).

If electing to use the Circulars, one of the first issues to resolve is whether to adopt one, such as A-87, for all organizations involved in the JTPA program, or to use all three, A-21, A-87, and A-122, depending on the type of organization involved. In deciding, consider the State system-wide impact of your approach. While it might be easier for GAE staff to administer one version of allowable cost guidelines for JTPA, the cumulative statewide burden may be greater because certain organizations would have to comply with two sets of guidelines.

Consider the following in deciding whether to use the OMB Circulars in formulating State allowable cost guidelines:

#### **Simplicity**

Use one or very similar versions of allowable cost rules for Federal funds rather than several. It is easier for everyone involved—the rules maker, the organizations complying with the rules, the monitors, and auditors.

#### **Cost**

Rule setting, managing, monitoring, and auditing in compliance with dissimilar versions of allowable cost rules increases effort and cost in the Administration cost category.

#### **Suitability**

Drawing the best from the OMB Cost Circulars will result in a workable set of allowable cost rules. A vast amount of experience has gone into getting the OMB

Circulars where they are today. Drafting completely new allowable cost rules probably would result in higher costs and problems usually experienced in start-up situations.

### **Adaptability**

States that adopt any part of the OMB Circulars may still make amendments that provide flexibility in specific situations and that contribute to improving JTPA program results. Because the Regulations only require the States to address allowable cost guidelines, States are encouraged to formulate guidelines that work best for them and the program, including modifications to the existing Circulars.

### **Flexibility**

A State will achieve complete flexibility by approaching the OMB Circulars as the basis for allowable cost rules, but allowing for changes that can benefit the JTPA program.

### **Precedent**

When the OMB Circulars are used as the basis for developing allowable cost rules, States will have existing materials to draw from when disputes arise over interpretations of cost allowability. Establishing new cost allowability standards will likely result in extra effort in establishing precedents and revisions due to "that's not what was meant" problems.

### **Restrictiveness**

OMB Circulars may contain requirements that are counterproductive to the success of the JTPA program. These requirements could be overlooked if not adequately reviewed in the haste to implement allowable cost rules.

### **Compliance with the Act**

As an example of the restrictiveness issue described above, the current version of A-87 does not address, and the draft currently out for review specifies, that fund-raising costs are unallowable. This may be contrary to the Act, which suggests their allowability at Section 103(e).

### **One Size Fits All**

The OMB Circulars are developed to cover three broad categories of organizations (State and local governments, educational institutions, and nonprofit organizations) without specific programs or their needs in mind. To adopt the Circulars without modification or clarification would result in the same less-than-ideal performance potential of any "one size fits all" product. This could also occur if one OMB Circular is adopted for all three broad categories of organizations.

## **JTPA Regulation Allowable Cost Guidelines**

The JTPA Regulations at 627.435 provide the following cost guidance:

- \* Some items are specified as allowable.
- \* Some items are specified as unallowable.
- \* 16 items are specifically identified as being the responsibility of the Governor.
- \* Other items among the 44 to 50 items addressed in the OMB Cost Circulars are simply not addressed. The regulation's "at a minimum" requirement leaves to the

Governor's discretion what other items will be addressed in each State's allowable cost guidelines.

This section lists the items specifically identified as allowable or unallowable by the JTPA Regulations. Only brief descriptions of the rules with reference cites are included. Comments are added when further explanation would be helpful.

### **Allowable Costs**

Section 627.435 of the Regulations should be reviewed for a complete description of the following items identified as allowable:

- \* Legal expenses directly related to operation of the JTPA program, with certain exceptions. (Note: Legal expenses must be approached with caution. The key to allowability is what is being done. Generally, the costs must directly benefit the program, and funds cannot be spent to prosecute claims against the Federal Government.)
- \* Settlement Costs to the extent that such costs included in the settlement would have been allowable if charged to the JTPA program at the time they were incurred. A combination example is back pay, which is allowable with exceptions. The portion of a settlement to pay a person for having actually performed higher grade level work is an allowable back pay cost. The portion of the same settlement for damages would not be back pay and is unallowable, because it would not have been an allowable cost as the work was performed.
- \* Travel and incidental expenses incurred by volunteers for activities consistent with section 204(c)(6) of the Act.
- \* Contributions to a reserve fund for a self-insurance program, to the extent that the type and extent of coverage, and the rates and premiums, would have been allowed had insurance been purchased to cover the risks. (The Proposed A-87 provides the best description of an acceptable self-insurance plan.)
- \* Construction Costs. It should be noted that construction costs are not specified as allowable by either the Act or the final Regulations. They have become allowable, however, subject to the cost principles (necessary and reasonable, etc.), because the prohibition contained in the Regulations since the inception of JTPA has been eliminated.

### **Unallowable Costs**

Review Section 627.435 of the Regulations for a complete description of the following items identified as unallowable:

- \* Fines and penalties.
- \* Back pay, with exceptions. See the related discussion on Settlement Costs in the Allowable Costs section.
- \* Entertainment costs (Note: The Proposed A-87 states that the cost of alcoholic



beverages is unallowable.)

- \* Bad debts expense.

- \* Insurance policies offering protection against debts established by the Federal Government.

- \* Contributions to a contingency reserve or any similar provision for unforeseen events. (Note: Contingency reserves do not include self-insurance reserves, pension plan reserves, post-retirement health and other benefit reserves computed using acceptable actuarial cost methods. A principal difference between a self-insurance reserve fund and a contingency reserve is that the cost of a self-insurance fund is based on what the cost of purchasing coverage would be while contingency reserves tend to be based on internally produced estimates unsubstantiated by data obtained outside the organization.)

- \* Costs prohibited by 29 CFR Part 93 (Lobbying Restrictions).

- \* Costs related to any activity designed to influence legislation or appropriations pending before the U.S. Congress.

- \* Activities prohibited in 627.205 Public Service Employment; 627.210 Nondiscrimination and nonsectarian activities; 627.215 Relocation (employer); 627.225 Employment-generating activities, foreign travel, with exceptions; and 627.230 Displacement. (Note: Capitalization of businesses, included in this part, includes such things as the cost of research, planning, and start-up and expansion of any business. It does not include prefeasibility studies allowed under EDWAA.)

- \* Legal services furnished by the chief legal officer or a unit of government, or staff, solely for the purpose of discharging general responsibilities as a legal officer.

- \* Legal expenses for the prosecution of claims against the Federal Government. (Note: States may wish to extend the same unallowability to claims against it.)

## **Governor's Sixteen Selected Items of Cost**

Since the inception of JTPA, the Governor has been responsible for issuing guidelines on allowable costs of the JTPA program. The requirement that the Governor must specifically address these 16 items has been added because of issues that have arisen concerning them over the past 10 years of JTPA.

This discussion of the Governor's 16 is based on the rationale that the OMB Cost Circulars are a good basis for discussion and that using them as such will require less explanation than starting from scratch. The OMB Cost Circulars must be read along with this material to obtain a full presentation. Remember that adoption of the OMB Cost Circulars, either in whole or part, for the JTPA program is at the discretion of the State.

The OMB Cost Circulars specifically address between 44 and 50 selected items of cost. Although many of the cost items are addressed by all three Circulars, differences exist because

of the nature of the organization they address. Only the 16 that the States must address are included in this section. This does not imply that the other items should not be considered for inclusion in State guidelines.

Guidelines issued by the Governor must be consistent with the cost principles and other allowable cost guidelines of the JTPA Regulations. The Governor must specify whether each of the 16 items is allowable or unallowable. For each item which is allowable, the Governor must issue:

- \* Guidelines on conditions or the extent of allowability
  - Note: There is no intention that the Governor should attempt to specify amounts. This was clarified by changing the Regulation language from "and amounts" to "or the extent of allowability."
- \* Documentation requirements
- \* Any prior approval requirements

### **1. Compensation for personal services of staff, including wages, salaries, supplementary compensation, and fringe benefits.**

This category is thoroughly addressed by the OMB Cost Circulars.

Two areas of frequent concern, documentation of how staff time is spent and what activities should be charged to what cost categories, are discussed in detail in the sections on Cost Allocation and Title II Cost Classification, Activities and Services.

The question of whether the Governor is expected to prescribe salary amounts of subrecipient staff is addressed by the deletion of the "amounts" requirement in 627.440(i). While the Governor is not required to establish salary amounts for subrecipient staff, guidance on methods for establishing amounts may be found in A-87 and A-122.

### **2. Costs incurred by the State Job Training Coordinating Council (SJTCC), Human Resource Investment Council (HRIC), Private Industry Councils (PICs), and other advisory councils or committees.**

OMB Circular A-87 addresses this issue at Advisory Councils. Examples of costs that may be allowable include, but are not limited to:

- \* Costs related to incorporation
- \* Directors and officers liability insurance
- \* Employment & Training-related seminars/workshops (council capacity building)
- \* HRIC activities, such as meetings and workshops
- \* Special and regularly scheduled planning meetings as they relate to PIC activities
- \* Honorariums for council or committee members attending meetings
- \* Travel costs of council or committee members
- \* Legal fees as they relate to Council issues, such as bylaw revisions and interpretations
- \* Council staff
- \* Organizational fees and memberships

### **3. Advertising costs**

All three OMB Cost Circulars and the Proposed A-87 address advertising to varying degrees. Without exception, they do not address advertising to attract or recruit program participants

and to seek employer participation in the program. It would be reasonable to specifically include such advertising in the Governor's allowable cost guidelines.

#### **4. Depreciation and/or use allowances**

All three OMB Cost Circulars and the Proposed A-87 address this subject.

The Governor's allowable cost guidelines should state that if the cost of acquisition is charged to a Federal grant, depreciation or use allowances cannot be charged to the JTPA program for that portion of the cost.

They should also include guidance in the following areas:

- \* How quickly costs can be depreciated
- \* Allowability of depreciation/use allowances on fully depreciated property (If the property is beyond its normal depreciable life, why should JTPA pay for its use?)

#### **5. Printing and reproduction costs**

OMB Circular A-87 and the Proposed A-87 provide guidance on this subject.

Guidance as to degree of allowability will probably be helpful to subrecipients. This cost item should address such things as ostentatious or unnecessarily expensive annual reports or promotional brochures, and any requirements for obtaining printing through a State central services agency.

#### **6. Interest expense**

The OMB Circulars address the issue differently.

While A-87 prescribes interest as an unallowable cost, with the exception of "rental rate" systems for building space costs, the Proposed A-87 provides more flexibility in allowing interest costs. This means the trend is moving toward recognizing interest cost as a reasonable cost of conducting government business.

It would be reasonable for the Governor's allowable cost guidelines to include interest, subject to limitations, as an allowable cost. Of most concern would be the purposes for which interest can be paid, limits as to allowable rates (linked to current published rates such as the Prime Lending Rate, for example), and that interest costs be clearly described in any purchases involving it (similar to a truth-in-lending statement). This last concern is important because transactions involving hidden interest are the most expensive method of purchasing goods.

While interest, for income tax purposes, does not generally include "fees" associated with such things as loan applications or loan payments, such items may, if considered allowable by the Governor, be considered as interest cost for JTPA purposes because they are a cost of money or interest.

Because government is generally not experienced in purchases involving interest, it might be wise to include a prior approval requirement, at least until the desired comfort level is achieved.

#### **7. Expenditures for transportation and travel**

These subjects are covered in all OMB Cost Circulars including the Proposed A-87, which incorporates a provision for default travel policies in the event that the governmental unit does not have any policies. It also updates the provisions for air travel to better reflect current ticket pricing trends in the airline industry.

Use of the Proposed A-87 language with appropriate changes for the organizations involved and any State-specific enhancements would be appropriate.

## **8. Payments to OJT employers, training institutions, and other vendors**

The OMB Cost Circulars are generally silent on this subject. A-122 has some material on the subject in the training and education costs item, but its specific criteria should not be applied to the JTPA program.

The best source of information to develop this item is the Act, JTPA Regulations, and the Governor's allowable costs guidance on the other 15 items. What you must construct is much like the intersection of two streets. One street consists of the activities and services on which funds may be spent, and the other street is the allowable cost guidelines consisting of specific kinds of expenses that can be incurred for the JTPA program. Allowable costs are limited to the area of the intersecting streets. For example, if alcoholic beverages are an unallowable cost, it makes no difference that the participants are using them in bartender training.

Training. The training cost guidelines of most concern should probably center on the issues of: "what are you buying?", "how do you go about buying it?", "how will you know when you get it?", "did it meet your expectations?", and "how, when, and how much will you pay for it?"

Before addressing training cost specifics, resolve general issues concerning permissible activities, allowable cost guidelines for the other cost items, general issues concerning organization-wide policies/procedures to follow, and preapproval requirements. A good place to start addressing training cost specifics is to identify what problems your State has experienced in the past.

The most important criteria to include in this area are requirements for sound procurement decision-making and follow-up procedures to ensure you are getting what you are paying for. Because there is adequate guidance for these subjects elsewhere, we will not go into further detail.

## **9. Fees or profits**

OMB Circulars A-21 and A-122 place the provision of profit or other increment above cost outside their scope, and both the current and the Proposed A-87 state that no provision for profit or increment above cost is intended.

Profit. Because these Circulars do not provide for fees or profit for organizations outside the "for-profit entities" category, the concept of fees or profits as a cost for governmental, nonprofits, and educational organizations is allowable only in accordance with the guidelines issued by the Governor that specify the extent and conditions under which fees or profits are allowable.

Section 627.420(e)(3) states that "JTPA procurements shall not permit excess program income (for nonprofit and governmental entities) or excess profit (for private for-profit

entities)." The chapter on Program Income should be reviewed before formulating guidelines for State and local governments and nonprofit organizations.

Profit for "for-profit entities" is an issue to the extent that such profit should not be excessive. The Regulations require that contract negotiators consider several factors when establishing a fair and reasonable profit or program income. The cost-plus-a-percentage of cost method for determining profit is not allowable.

Some factors to consider when determining profit are:

- \* Contractor Effort. The complexity of the work to be performed; that is, the complexity of the skills to be learned and the technical skills needed to teach. The higher the level of complexity, the higher the fee should be. The amount of subcontracting and the level of management involved should also be factored in when determining profit.
- \* Contract Cost Risk. The risk borne by the subgrantee; that is, potential for financial loss. The more risk that a subgrantee must assume, the higher the profit potential should be. Use of fixed-price contracts increases the contractor's risk above that of cost-plus contracts. Performance-based, fixed-price contracts are potentially the riskiest of all for a contractor.
- \* Offeror's Investment. The offeror's investment; that is, the potential benefit foregone by rejecting one alternative while accepting another. For example, the income that will be lost from an alternative investment such as a bank certificate of deposit is an opportunity cost associated with the decision to operate a JTPA program.
- \* Past Performance. The quality of the offeror's record of past performance in providing similar services.
- \* Type of Industry. Industry profit rates in the surrounding geographical area for similar work.
- \* Market Conditions. Market conditions in the surrounding geographical area can easily affect profit rates.
- \* Socioeconomic Programs. At the State or local level, there are often social and economic goals such as small and minority business programs, affirmative action for the handicapped, and energy conservation that can be recognized and reflected in the profit negotiated.

In addition, the Governor may introduce an absolute cap combined with dollar limits on profits based on the dollar value of the agreement, i.e., percent of total contract not to exceed a specified amount.

Profit, if allowable, may be allocated to all three cost categories (Administration, Direct Training Services, and Training-Related and Supportive Services) based on the proportionate share of actual costs incurred attributable to each category. (627.440(e)(4))

**10. Insurance costs, including insurance coverage for injuries suffered by participants who are not covered by existing workers' compensation, and personal liability insurance for PIC members**

This subsection does not apply to insurance that represents fringe benefits for employees.

The OMB Cost Circulars cover the subject of insurance but do not provide specific guidance concerning program participants or personal liability of persons in decision-making groups. The Proposed A-87 expands the guidance for organizations that use self-insurance reserve funds.

Development of State allowable cost guidelines for this subject is more complex than it first appears. The Act and the Regulations, in other sections, provide requirements that must be incorporated into the State guidelines. These requirements address not whether certain items are allowable costs, but how they are to be provided.

Insurance in General. The JTPA Regulations provide the following requirements and guidance on insurance in general:

- \* Each recipient and subrecipient shall follow its normal insurance procedures except as otherwise indicated. (627.415)
- \* DOL assumes no liability. (627.415)
- \* Contributions to a reserve fund for a self-insurance program are allowable, to the extent that the type and extent of coverage and the rates and premiums would have been allowed had insurance been purchased to cover the risks. (627.435(h))
- \* Insurance policies offering protection against debts established by the Federal Government are unallowable. (627.435(e)(5))

Typical insurance costs include:

- \* Real property and equipment.
- \* Fidelity bonding insurance for individuals involved with JTPA programs.
- \* Insurance deductibles, as incurred, in keeping with sound business practice of coinsuring assets.
- \* Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations.

Participants. In the case of participants, the Act states at Section 143(a)(3) and the Regulations reiterate at 627.315 that to the extent that a State workers' compensation law is applicable, workers' compensation benefits in accordance with such law shall be available with respect to injuries suffered by participants. They go on to prescribe that where participants are not covered by such law, they shall be provided with adequate on-site medical and accident insurance. Considerations for obtaining and providing coverage for participants include:

- \* General principles applicable to insurance, including procurement guidelines.
- \* All participants in work-related activities are to be covered, not just those in OJT. It is acceptable to provide coverage to all participants.
- \* Do you provide coverage by a state-wide program or do you require each organization to obtain its own coverage?
- \* Are HMO-type services available that might be more cost effective than other forms

of coverage?

**Personal Liability.** The subject of personal liability insurance for PIC members is not addressed in the Act or elsewhere in the Regulations. Some considerations for developing allowable cost guidelines for personal liability insurance for PIC members are:

- \* Whether the coverage provided by the current general liability policy of the organization they represent is insufficient to provide protection for liability incurred as a result of their actions regarding JTPA.
- \* JTPA funds used for purchasing personal liability insurance for PIC and support staff should not replace local funds that otherwise would have been used to purchase such liability insurance.
- \* Costs of a group policy to cover all PIC members compared to providing coverage of individual's "gaps."

### **11. Acquisition of capital assets**

All the OMB Cost Circulars address this issue but provide very little guidance as a basis to establish State allowable cost guidelines.

JTPA Regulations specify requirements for the management of property but leave the development of guidelines for acquisition to the States. Even though they have full freedom, States should consider current and past problems in developing acquisition rules that minimize the unnecessary expenditures of JTPA funds. Of most importance is the need to define State prior approval requirements and whether JTPA funds should be used to acquire property or to reimburse organizations for its use through depreciation or use allowances.

Chapter 7, Property Management, provides more discussion on developing allowable cost guidelines for acquisition of assets.

**12. Building space costs, including rent, repairs, and alterations.** All of the OMB Cost Circulars address this issue and provide sufficient guidance for establishing State allowable cost guidelines.

An issue that States may wish to address, if not covered adequately in the Depreciation and/or Use Allowance item, is whether charges other than utilities and upkeep on fully depreciated buildings owned by governmental and nonprofit organizations are allowable costs. If the property is beyond its normal depreciable life, why should JTPA pay for its use?

**13. Preagreement costs.** All of the OMB Cost Circulars provide guidance on this subject.

Such costs should meet all allowable cost guidelines. It is reasonable to require prior written approval of the awarding agency. If preagreement costs are allowable without specific prior approval on what is being allowed, the awarding agency is exposing itself to a broad range of costs it may not want to pay.

### **14. Fund-raising activities.**

Little guidance is available for drafting allowable cost guidelines. A-21 and A-122 treat

fund-raising costs as unallowable, OMB Circular A-87 does not address fund-raising activities, and the proposed A-87 prescribes that these activities are unallowable.

In describing the functions of the PIC, Section 103(e) of the Act states that the PIC, among other things, "may solicit and accept contributions and grant funds (from other public and private sources)."

Because the Act does not address the allowability of fund-raising costs, extreme care must be taken in drafting cost guidelines that include:

- \* Whether they are allowable or unallowable.

If allowable:

- \* Conditions or the extent of allowability

- \* Documentation requirements

- \* Any prior approval requirements

If fund-raising is made an allowable cost, it should be charged to the Administration cost category to the extent that benefits are received. It also must meet the general JTPA cost principle of being necessary and reasonable for the proper and efficient administration of the program.

Preparing allowability guidelines is extremely difficult because of the problems of meeting the necessary and reasonable requirement, and how to argue that any benefit has been received if the expenditure of funds does not result in obtaining additional funds. No clear guidance has emerged at this time to aid the GAEs in this area.

### **15. Professional services, including organizational management studies conducted by outside individuals or firms.**

OMB Circulars A-21, A-122, and the Proposed A-87 provide sufficient guidance on this subject to serve as a basis for drafting State allowable cost guidelines. Past and current problems in this area should be considered in customizing the guidelines for your State.

### **16. Taxes.**

All three OMB Cost Circulars and the Proposed A-87 address this subject. The Proposed A-87 offers the clearest guidance on the subject but cannot be used as is, because the Federal Government can affect the taxing authority of State and local jurisdictions using powers that are not always available to the executive branch of State and local governments.

Consider the following in developing guidelines on this subject:

- \* Taxes levied by a higher authority must be an allowable cost. Example: Federal gasoline tax.

- \* If there are no provisions for exemption from the tax, the tax must be an allowable cost.

- \* General sales taxes that a government assesses upon itself might be considered an unallowable cost as is done in the Proposed A-87. Sales tax, for example, if paid on participant training, would result in fewer participants being trained. The expected



result would be less direct benefit to the program than the roundabout benefit derived by the sales tax.

\* User fee taxes, such as gasoline tax, providing a benefit to the program, should be allowable.

\* Any provisions for exemption should be pursued. Such taxes should be unallowable except in cases in which the exemption provision accounting requirements make it more cost effective to pay the tax.